



STATE OF WASHINGTON

**LAW ENFORCEMENT OFFICERS' AND FIRE FIGHTERS'  
PLAN 2 RETIREMENT BOARD**

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**To:** Steve Nelsen, Executive Director

**From:** Tim Valencia, Sr. Research and Policy Manager

**Date:** August 24, 2005

**Re: Recent Developments Involving Military Differential Pay**

The purpose of this memo is to summarize recent developments regarding military differential pay. Military differential pay is the compensation an employee may receive from his or her employer while on active military service. This compensation is normally computed as all or a portion of the difference between the employee's regular wages and the pay he or she receives from the military. Military differential pay is not currently reportable for retirement purposes.

### **The Federal Government Position**

Throughout the years, the Internal Revenue Service (IRS) has released several revenue rulings stating that military differential pay does not constitute wages subject to withholding since the employment relationship ends when the individual is called to active military service. A 2004 IRS ruling reaffirmed the previous revenue rulings. However, there have been recent developments attempting to address issues with military differential pay.

### **Recent Developments**

#### **Uniformed Services Differential Pay Protection Act**

On July 14, 2005, Senator Judd Gregg introduced in Congress the Uniformed Services Differential Pay Protection Act, (S.1401), which amends the Internal Revenue Code to treat differential wage payments as a payment of wages by an employer to an employee for income tax purposes. The bill provides that differential wage payments would be treated as compensation for retirement plan purposes. The Uniformed Services Differential Pay Protection Act (S.1401) is currently in the Senate Finance Committee.

#### **US Treasury and Internal Revenue Service Regulations**

The US Treasury and IRS released proposed regulations on May 25, 2005 that would allow members to contribute to qualified retirement plans while on leave for military service and while receiving military differential pay from their employer. A public hearing on the proposed regulations is scheduled for August 17, 2005 and final regulations will be issued at a later date. A change in state statute would be necessary to implement any new regulations because military differential pay is excluded from "basic salary" in LEOFF Plan 2.